10/27/83 B4750-1

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Oct. 21, 1983

Some of the well known bears of Wall Street have come out of their dens to sound a note of caution and to predict that rises in interest rates are inevitable as public and private credit demands clash. While this phenomenon, called crowding out, is a matter of some concern, I would direct that concern to a point further into the recovery. For now, I feel crowding out is not a problem. We should have almost another year before crowding-out effects become substantial enough to preclude the possibility of some modest rate declines from current levels.

The concept of crowding out has been popularized in recent years. It maintains that there is a queue for credit with the public sector always first in line. As public sector demands for credit grow--in the presence of unchanged private sector demands --they put pressure on interest rates, and this process causes private sector borrowers to cease to want to borrow at prevailing market rates. Businesses postpone the projects that would have been financed by their borrowings. Crowding out therefore results in a replacement of private sector expenditure with public sector expenditure in addition to its impact on interest rates.

There are two elements to the crowding out story: the public sector and the private sector. In this economic recovery, it is already widely conceded that the government's deficits will be massive over the foreseeable horizon--so much for the public sector. Then what about the private sector? Thus far, the private sector hasn't produced much of a strain. According to the widely cited flow of funds data, nonfinancial corporations have been running a large financial surplus. The largest private sector use of funds has been through the household sector's demand for mortgage financing. However, because of the mortgage-pooled securities, the banking sector needn't be the supplier of all these mortgage demands. Yet the banking sector is usually in the middle of the crowding out picture. Commercial banks, for example, will invest heavily in government securities when other credit demands are slack. In the first half of this year, they bought governments at nearly an $80 billion annual rate. As private credit demands pick up in the future--for inventory and investment--securities purchases by banks will decline, and eventually holdings of securities may be sold outright. This really reflects how crowding out works in practice. As banks take on the higher yielding private sector assets, the nonbank sector must absorb increasing amounts of U.S. Treasuries. If, initially, savings are not sufficient to support the increased credit demands, interest rates rise, leading to greater savings flows enabling investors to hold the now higher-yielding securities. This is a bit of an involved process. It does not happen overnight. Don't confuse crowding out with what happened in the aborted 1980 economic recovery. That was excessive money demands bumping against a restricted money supply. The process of crowding out will be slower, more subtle, and later in starting.

Robert A. Brusca

Irving Trust

Market Yields

	10/21/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	12.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	9.50
Federal Funds	9.31	9.25	9.38
Repurchase Agreements	9.25	9.13	9.25
U.S. Treasury Issues			
Bills			
3 months	8.82	9.09	7.86
6 months	9.23	9.51	8.47
1 year	9.64	9.87	9.02
Coupons			
2 years	10.50	10.65	9.87
4 years	10.98	11.14	10.49
7 years	11.39	11.55	10.68
10 years	11.45	11.60	11.18
Long Bond	11.51	11.64	10.96
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.10	9.15	8.85
3 months	9.15	9.20	8.90
6 months	9.30	9.40	9.20
1 year	9.80	9.80	9.60
Banker's Acceptances			
1 month	9.10	9.15	8.75
3 months	9.21	9.30	8.90
6 months	9.31	9.45	9.25
Eurodollar Deposits			
1 month	9.50	9.62	9.50
2 months	9.56	9.69	9.63
3 months	9.63	9.75	9.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.14	9.27	8.63
1 month	9.19	9.33	8.56
3 months	9.21	9.34	8.54
Bank Holding Companies			
1 month	8.81	9.19	7.91
Dealer Placed:			
3 months	9.31	9.36	8.40
New AA Corporate Utility Bond	12.50	12.65	12.75
Tax Exempt			
6 month Project Notes	5.25	5.35	4.50
1 year AAA Bond	5.50	5.75	5.25
5 year AAA Bond	7.00	7.00	7.00
20 year AAA Bond	9.60	9.60	8.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629